Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Implementation of the	)	CC Docket No. 96-128
Pay Telephone Reclassification	)	
and Compensation Provisions of the	)	DA 97-1673 (Remand)
Telecommunications Act of 1996	)	
	)	

REPLY COMMENTS OF THE COMPETITION POLICY INSTITUTE

ON REMAND ISSUES IN THE PAYPHONE PROCEEDING

Ronald Binz, President and Policy Director
Debra Berlyn, Executive Director
John Windhausen, Jr., General Counsel

Competition Policy Institute
1156 15th St. N.W. Suite 310
Washington, D.C. 20005
Phone: (202) 835-0202
Fax: (202) 835-1132

September 9, 1997

Reply Comments of the Competition Policy Institute
on Remand Issues in the Payphone Proceeding
CC Docket No. 96-128

I. Introduction

The Competition Policy Institute (CPI) respectfully submits these Reply Comments in response to the Commission's Public Notice DA 97-1673 concerning the matters raised in the D.C. Circuit Court of Appeal's remand of certain portions of the Commission's *Payphone Orders.*[1] CPI is an independent non-profit organization that advocates policies to bring competition to energy and telecommunications markets in ways that benefit consumers. CPI appreciates the opportunity to reply to the comments of other parties on these matters because of the significant issues raised for competition in the payphone industry and because of the very substantial effect these orders will have on the rates paid by consumers.

II. The Commission Should Base The Default Compensation Rate on the Cost of Providing Subscriber 800 Calls and Access Code Calls

The Court remanded the portion of the Commission's decision in which the "default" rate for compensation for subscriber 800 calls and access code calls was set at 35 cents per call, the same rate as the maximum rate for local coin calls during the second year of the interim period. The Commission sought comments on whether there are cost differences between local coin service and subscriber 800 calls and access code calls. The Commission also sought comments on how

---

[1] *Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996*, CC Docket No 96-128. The Report and Order ("*Payphone Order*") and Order on Reconsideration ("*Order on Reconsideration*") are referred to as "*Payphone Orders*."

any cost differences should affect a market-based compensation amount. Finally, the Commission sought comments on whether the local coin rate, adjusted for cost differences, is an appropriate default rate to use for compensation to payphone service providers (PSPs).

CPI agrees with those commenters that urge the Commission to base the interim compensation on a reasonable estimate of the costs of completing coinless calls from payphones[2]. Our support for this position grows out of two observations: 1) the payphone industry is not now sufficiently competitive to allow the Commission to conclude that *deregulated* prices are the same as *competitive* prices; and 2) there are enough differences between the cost structures of local coin calls and coinless calls that basing compensation on coin costs will produce an unreliable result.

The Commission concluded that 35 cents is the market price of local coin service on the basis of coin rates in five states with deregulated coin phone rates. But the Commission errs in assuming that sufficient competition exists in the payphone business to conclude, on such scant evidence, that 35 cents is a market-based rate for payphone charges. As we pointed out in our Comments, 35 cents is the predominant *deregulated* price for a local call from a payphone. There is no reason to believe that 35 cents is also the price that a competitive payphone industry would achieve. The Commission could just as easily have concluded that 35 cents represents a fairly accurate estimate of the *monopoly* price for local coin calls.

---

[2]See, for example, Comments of Frontier at 2, LCI at 7, International Telecard Association at 2, and Midcom Communications at 3.

CPI does not disagree with the basic premise that a competitive market is superior to regulatory scrutiny and cost studies when determining a competitive price for coin phone service. In that regard, we agree with the RBOC/GTE/SNET Payphone Coalition that, in a competitive market, market-based rates will be superior to rates which are set as the result of regulatory cost studies.[3] The problem is that a competitive payphone market does not now exist. Further, there are structural impediments to the sort of competition that will drive prices to cost. Today, location owners and payphone providers exercise market power, consumers lack a sufficient understanding of the industry, and the combination of locational monopolies and the commission structure of the PSP contracts conspire to keep prices above competitive levels. In 1997, competition in the payphone sector means competition among PSPs for locations — *not* competition among PSPs seeking to win consumers' business by providing the lowest price.[4]

While the Commission frequently acknowledges, in its *Payphone Orders,* that the market for payphones is not competitive, the Commission still proceeds to move to deregulate the industry and establish interim compensation rates based on deregulated prices in five states and default permanent rates on a fiction — that 35 cents represents the competitive price of a local coin call.

The Commission partially supports its decision to adopt 35 cents as the default rate on its belief that IXCs can block calls from payphones if the rate is "too high." The Commission reasons that

---

[3]See Comments of the RBOC/GTE/SNET Payphone Coalition at iii.

[4]For a complete discussion of this point, see the Comments of Telecommunications Resellers Association at 18.

this ability to block calls gives the IXCs leverage to negotiate with the PSPs to constrain the rate of such compensation. Several of the commenters showed why consumers should take little comfort in this scenario.

First, it is only theoretically possible to track individual payphone charges in a manner sufficient to allow blocking of specific payphones. In fact, the cost of tracking individual payphones and blocking exactly that traffic may be prohibitively high for the interexchange carriers. We fear that IXCs might take the easy way out and merely build in excessive charges into their calling card or 800 service rates. Like many other "market" mechanisms, this one must be tested for its feasibility.

Second, consumers are hardly benefitted by encountering payphones where access is blocked. Consumers want to place calls, not spend time figuring out which payphones are blocked and why.[5] Given the history of the OSP industry, we predict that a customer at a payphone who is denied 800 access or dial-around access might well give up in exasperation and use the pre-subscribed carrier, and perhaps be exploited by that carrier's price. This should sound familiar — it is exactly the recipe that made the OSP abuses possible. In short, it would be a giant step backward for the Commission to recreate the incentives that spawned the abuses of the operator service providers.

[5]See Comments of GCI at 3. "Moreover, GCI does not want to block calls from payphone locations. This would only inconvenience and frustrate GCI's customers..."

Third, there is no reason to think that a compensation level determined using the IXCs' leverage to block will result in a price that is market-based. Where PSPs are monopolies (or near-monopolies), the PSPs will select a per-call rate that maximizes revenues, even if that means that some calls are blocked. That is, they will maximize revenue even if output is limited. But this is *precisely* the economics definition of a monopoly price. The ability of an IXC to block a call when the price is too high does not mean that the resulting price (just below the blocking threshold) will equal the price that a competitive market would deliver. It simply means that the PSP has extracted the maximum revenue from the interexchange carriers and the consumers they serve.

CPI agrees with those commenters who suggest that the Commission must use a "bottom up" approach to determining a fair level of compensation for payphone calls that are not otherwise subject to compensation. It would be a mistake to compute the differences between local coin call costs and the costs of subscriber 800 calls and access code calls and then reduce the 35 cent rate and arriving at a revised default compensation rate. CPI suggests this approach will compound the error made by assuming that the 35 cent rate is the competitive price for local coin costs. Further, this method assumes a basic similarity between coin calls and these other compensable calls which may not exist, and will not produce an accurate rate for compensating PSPs for subscriber 800 calls and access code calls. Instead of using this "top down" method based on the 35 cent rate, the Commission should determine the correct level of compensation by examining the costs of providing the service when setting this rate.

In this regard, we agree with analysis of Frontier[6] that connects competitive rates and cost-based rates. It is an axiom of economics that a competitive market will produce prices that are based on *costs.* A competitive market keeps a producer from persistently charging more than the cost of producing a product. If above-cost prices are attempted, another competitor will enter the market and undercut the price, forcing the first producer to reduce the price or leave the market. In short, competition drives prices to cost. There is nothing incorrect about the Commission setting maximum rates for compensation to PSPs based on these providers' costs when market pressures are insufficient to achieve that result. Using cost as the basis for compensation for PSPs does not violate the Commission's commitment to use competitive forces to determine prices whenever possible.[7]

The Commission's obligation under Section 276 of the Communications Act may include the requirement that it ensure fair compensation for payphone service providers and promote competition in the payphone business, but that does not mean that the Commission must abandon its overarching obligation to ensure that prices for telecommunications services are just and reasonable. The Commission does not serve the public interest by permitting firms with market power to collect rates that bear no relation to the costs of providing a service in the name of promoting competition.[8]

---

[6]Comments of Frontier at 5-6.

[7]Id., at 6.

[8]Consider the absurd results that follow from mixing market power and monopoly prices: while Teleport submits that most payphone costs are fixed, (Teleport Comments at 4),

III. The Commission Should Apply Retroactively Changes to the Interim Compensation Rate To the Extent It Is Legal, Feasible and Lowers Rates to Consumers.

If the Commission determines, as it should, that its interim compensation plan must be adjusted, then the Commission should apply the revised rate and structure retroactively. CPI is aware that there is substantial debate whether this would constitute retroactive ratemaking.[9] Nonetheless, we believe that a retroactive adjustment is the correct approach, in principle, if legally permissible.[10] However, even if this approach passes legal muster, such action must also be feasible and cost effective and should benefit consumers. Further, the Commission should attach certain conditions to any refunds that occur as a result of the retroactive application of a corrected interim plan. In particular, CPI endorses the retroactive adjustment of compensation rates <u>only if</u> the resulting rate reductions find their way back to the consumers who paid higher rates. We examine three elements of the interim plan that were remanded by the Court for their suitability to retroactive adjustment.

Compensation Rate. If the Commission determines that the per-call compensation rate for the

---

Communications Central reasons that, since call volumes have increased from 129 to 157 calls per month, the flat-rate interim compensation should be *increased* to $54.95 per month, even though costs would not have changed much. In a competitive market, a rivalrous firm could not unilaterally increase its profits by 20% with such impunity.

[9]For example, contrast the Comments of Sprint at 16 ("The Commission's authority to so correct for the errors in its prior decisions is beyond question.") with the Comments of Worldcom at 8 ("...there is no lawful basis for the Commission to set a new per-phone rate and attempt to apply it retroactively.")

[10]On this point we concur with the Comments of the RBOC/GTE/SNET Payphone Coalition at 39.

interim period should have been lower than the implied rate of 35 cents per call, the Commission should instruct PSPs to refund the difference to the IXCs that have paid the higher rate since November 6, 1996. We also concur with the commenters who suggest that such a refund may be accomplished through the prospective reduction of compensation to PSPs[11]. However, the Commission should also obtain a commitment from such IXCs that, to the extent they have re-collected this charge from their customers, they will also refund the overcharges to their customers. No provider should experience a windfall either from the incorrect compensation level or from the correction of that error.

Inclusion of Small IXCs. The Commission decided to exempt IXCs with annual revenues less than $100 million from the requirement to share in flat rate compensation during the first year of the interim period while requiring these carriers to pay per-call compensation beginning on October 7, 1997. The Court remanded this issue to the Commission for further consideration.

Because the first year of the interim period has nearly elapsed, this issue will soon be moot unless the Commission requires the smaller IXCs carriers to compute, retroactively, their share of the flat rate compensation paid to PSPs during the first year. CPI agrees with the commenters who argue that all IXCs should share in the cost of compensation paid to payphone owners, small IXCs as well as large ones.[12]

---

[11]See Comments of Sprint at 16.

[12]We also agree that the Commission should have included LECs that carry long distance traffic as payers under the interim plan.

In determining whether to include the smaller IXCs retroactively, the Commission must consider several factors: 1) whether and how these carriers will be able to recoup this contribution from their ultimate customers; 2) whether smaller IXCs, especially resellers, have been charged for a portion of the compensation by their underlying carriers[13]; 3) the degree to which a retroactive application to the smaller IXCs will affect the compensation levels paid by others; and 4) the feasibility of determining the share of the total compensation pool that should be borne by each such small IXC. CPI submits that, while in principle small IXCs should be assessed, it is unclear whether a retroactive application will prove to be cost effective and feasible.

Compensation to BOCs for 0+ Calls. Section 276 of the Communications Act requires the Commission to adopt rules to provide compensation for "each and every call" placed from a payphone. The Court questioned why the Commission excluded 0+ calls from the compensation scheme during the interim period and directed the Commission to "correct this flaw" in the interim compensation scheme.

As an initial matter, we concur with the Commission and some commenters that the Court's concern is limited to the "0+" calls that are not compensated through a contractual arrangement. CPI agrees that the BOCs should be compensated for "0+" calls, but only if they are not

[13]We note the Comments of the Telecommunications Resellers Association who submit that retroactive application to resellers would cause some to pay twice.

otherwise compensated for the calls[14]. However, the unique historical relationship among the BOCs, the IXCs, the location owners who situate BOC payphones, and consumers who still do not understand their competitive choices, makes the decision whether the BOCs are "otherwise compensated" difficult to determine. The Commission is justified in proceeding carefully to qualify BOC "0+" calls for compensation during the interim period. We also agree with several commenters who observed that few BOCs would have qualified for compensation during the interim period under the conditions set out by the Commission for their eventual receipt of compensation for 0+ calls, *viz.*, that the BOCs disentangle payphone costs from the provision of other local exchange service.[15]

---

[14]This position assumes, of course, that the Commission has adopted the correct price for the compensation, as discussed above.

[15]CPI suggests that, in order to comply with the Court's mandate, the Commission should require compensation for a BOC's "0+" calls beginning during the second year of the interim period if the BOC has transferred its payphone business to a separate subsidiary and has established that it is not receiving any other compensation for its payphone costs. In this way, the Commission can assure itself that the BOCs are on an equal footing with independent PSPs. This policy also looks ahead to the additional difficulties that arise when the BOCs enter the long distance business in competition with the same IXCs whom they serve through contractual arrangements on payphones. CPI suggests that this policy-based distinction between the BOCs and independent PSPs in the treatment of "0+" calls will prove an adequate response to the Court's requirements.

IV. Conclusion

CPI appreciates the opportunity to present these reply comments on some of the issues raised in the Court's remand of the Commission's *Payphone Orders*. We respectfully request that the Commission modify its orders as recommended in these comments.

Respectfully Submitted,

Ron Binz

Competition Policy Institute

Ronald Binz, President and Policy Director
Debra Berlyn, Executive Director
John Windhausen, Jr., General Counsel

Competition Policy Institute
1156 15th St. N.W. Suite 310
Washington, D.C. 20005
Phone: (202) 835-0202
Fax: (202) 835-1132

Certificate of Service

I, Bridget J. Szymanski, hereby certify that on this ninth day of September, 1997, copies of the foregoing Comments of the Competition Policy Institute were served by hand or by first-class, United States mail, postage prepaid, upon each of the following:

Chief
Enforcement Division
Common Carrier Bureau
Stop 1600A
2025 M St., NW Room 6008
Washington, DC 20554

International Transcription Service
1231 20th St., NW
Washington, DC 20036

Secretary
Federal Communications Commission
Room 222
1919 M St., NW
Washington, DC 20554

Mr Greg Lipscomb
Common Carrier Bureau
Federal Communications Commission
2025 M St., NW Room 6336-A
Washington, DC 20554

Robert L. Hoggarth
Personal Communications Industry Association
500 Montgomery St., Ste 700
Alexandria, VA 22314

Teresa Marrero
Senior Regulatory Counsel – Federal
Two Teleport Dr.
Staten Island, NY 10311

Albert Kramer
Robert Aldrich
Jacob Farber
Dickstein, Shapiro, Morin & Oshinsky, LLP
2101 L St., NW
Washington DC 20037-1526

Mary McDermott
Linda Kent
Keith Townsend
Hance Haney
1401 H St., NW Suite 600
Washington DC 20005

Lisa Mullings
NATSO
1199 North Fairfax St. Suite 801
Alexandria, VA 22314-1492

Genevieve Morelli
Comptel
1900 M St., NW Suite 800
Washington DC 20036

Scott Blake Harris
Kent D. Bressie
Gibson, Dunn & Crutcher, LLP
1050 Connecticut Ave., NW
Washington DC 20036

Glenn Manishin
Michael Specht
Blumenfeld & Cohen
1615 M St., NW Suite 700
Washington DC 20036

Michael Shortley
Frontier Corporation
180 South Clinton Ave
Rochester, NY 14646

Mary Sisak
Mary Brown
1801 Pennsylvania Ave., NW
Washington, DC 20006

Mark C Rosenblum
Richard Rubin
Jodie Donovan-May
AT&T
295 North Maple Ave. Room 3252I3
Basking Ridge, NJ 07920

Charles C Hunter
Hunter & Mow, PC
1620 Eye St, NW Suite 701
Washington, DC 20006

Bruce W Renard
Peoples Telephone Co.
2300 NW 89th Place
Miami, FL 33172

J Christopher Dance
Kerry Tassopoulos
Excel Telecommunications
20th Floor
8750 North Central Expressway
Dallas, TX 75231

Thomas K. Crowe
Excel Telecommunications
2300 M St., NW Suite 800
Washington, DC 20036

Leon Kestenbaum
H Richard Juhnke
Sprint Corporation
1850 M St., NW 11th Floor
Washington, DC 20036

Reginald R Bernard
SDN
PO Box 4014
Bridgewater, NJ 08807

Charles Helein
Helein & Assoc
8180 Greensboro Dr. Ste 700
McLean, VA 22102

Danny Adams
Steven Augustino
John Heitman
Kelley Drye & Warren, LLP
1200 19th St., NW Suite 500
Washington DC 20036

Rachel J Rothstein
Cable & Wireless
8219 Leesburg Pike
Vienna, VA 22139

Michael Kellogg
Jeffrey Lamken
Kevin Cameron
Kellogg, Huber, Hansen, Todd & Evans
1301 K St., NW Suite 1000 West
Washington, DC 20005

Dana Frix
William Wilhelm Jr
Swider & Berlin, Chtd
3000 K St., NW Suite 300
Washington, DC 20007

C Douglas McKeever
Communications Central
1150 Northmeadow Parkway, Suite 188
Roswell, GA 30076

Kathy Shobert
Director, Federal Affairs
General Communications Inc
901 15th St., NW Ste 900
Washington, DC 20005

Theodore Rammelkamp
Telaleasing Enterprises
601 West Morgan
Jacksonville, FL 62650

Mark Stachiw
Airtouch Paging
12221 Merit Dr., Suite 800
Dallas, TX 75251

Judith St Ledger-Roty
Wendy Kirchick
Paging Network
Kelley Drye & Warren
1200 19th St. NW Suite 500
Washington, DC 20036

Carl Northrop
E Ashton Johnston
Airtouch Paging
Paul, Hastings, Janofsky & Walker
1299 Pennsylvania Ave., NW
10th Floor
Washington, DC 20004-2400

Bridget J Szymanski

Bridget Szymanski
Office Manager